

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

In Re:)	Case No. 95-31004
)	Chapter 13
ELLEN MCCARN CALHOUN,)	
)	
Debtor.)	
)	

ORDER ALLOWING CLAIM

This matter comes before the Court on the Objection to Claim filed by the Trustee on September 13, 1995 and the Creditor's Response to that objection filed October 11, 1995. In the Objection, the Trustee challenges the proof of claim filed by Kentucky Finance Company, Inc. ("KFC") indicating a secured claim in the amount of \$3,863.60. The Trustee's Objection is based on his assertion that KFC has provided no proof of a perfected security interest. KFC argued that the doctrine of equitable subordination provided the basis for their secured claim in response to the Trustee's objection. A hearing was held on the matter in Charlotte, North Carolina on October 24, 1995. Based on that hearing and the Court's records the following appears:

1. The Debtor filed for Chapter 13 relief on July 12, 1995. An order confirming her plan was entered on August 21, 1995.
2. In June, 1994 or approximately one year prior to filing her Chapter 13 plan, the Debtor obtained a loan from KFC to pay off the existing loan on her 1987 Ford automobile ("Ford") and debts to other creditors. As security for the loan, the Debtor granted KFC a security interest in the Ford. The security interest was properly noted on the Truth in Lending Disclosure Statement.
3. Pursuant to the loan documents, KFC tendered a check to Shields Auto ("Shields") in the amount of \$1,685.00 to pay off the only lien on the Debtor's Ford.
4. Following the payoff, KFC understood that Shields would mark their lien satisfied and send the title to KFC, allowing KFC to request a new title noting their lien. In fact, Shields returned the title to the Debtor. KFC did not realize this error had occurred for a considerable period of time.
5. The Debtor fell behind on her payments to KFC in March of 1995. As a result, KFC agreed to refinance her debt, bringing her account current. The Debtor again granted KFC a security interest in the Ford. At that time, KFC realized it did not have the title to the Ford, and requested that the Debtor deliver the title to KFC. The Debtor assured KFC she would. However, the Debtor failed

to comply with this request. KFC made repeated inquiries about the title over the next several months, but to no avail. Subsequently, the Debtor filed her bankruptcy petition.

6. In her bankruptcy petition, the Debtor listed KFC as a general unsecured creditor in the amount of \$3,864.00 with a second lien on the Ford. In addition, the Debtor listed a secured claim in the amount of \$622.00 in favor of Auto Finance, noting that Auto Finance has a purchase money security interest in the Ford.

7. KFC has filed a proof of claim in this case asserting that its claim against the Ford is secured. Subsequently, the Trustee filed an objection to KFC's claim arguing that KFC never provided proof that its security interest in the Ford was perfected.

8. At the October 24 hearing, KFC argued that, under the doctrine of equitable subrogation, it was entitled to a secured claim, even though it failed to properly perfect its security interest in the Ford under North Carolina law by noting the lien on the certificate of title. The doctrine of equitable subordination, as recognized under North Carolina law, was defined by the North Carolina Supreme Court in Peek v. Trust Co., 241 N.C. 1, 84 S.E.2d 321 (1955). The Peek Court stated the relevant rule as:

[o]ne who furnishes money for the purpose of paying off an encumbrance on real or personal property, at the instance . . . of the owner of the property . . . on the express understanding . . . that the advance made is to be secured by a first lien on the property, will be subrogated to the rights of the prior lienholder as against the holder of an intervening lien, of which the lender was excusably ignorant.

Id. at 241 N.C. 15. In this case, KFC loaned the Debtor funds to pay the Shields debt in full. In exchange, the Debtor expressly granted KFC a security interest in the property upon which Shields held a lien, the Ford automobile. In addition, KFC made numerous attempts to obtain possession of the title, but was unsuccessful due to a failure to cooperate on the part of the Debtor. Therefore, under Peek and outside bankruptcy, KFC would clearly be entitled to be subrogated to the rights of Shields and to have its claim secured.

However, because the Debtor is currently in bankruptcy, the Court must consider the effect of the Trustee's "strong arm" powers under 11 U.S.C. § 544(a)(1). Under section 544(a)(1), the Trustee is given the power of a lien creditor as to the Debtor's personal property. The Fourth Circuit has held that the extent of the Trustee's strong arm power is determined by applicable state law. Havee v. Belk, 775 F.2d 1209 (4th Cir. 1985).

Following the reasoning of In re White, a case from the Bankruptcy Court, Middle District of North Carolina, it is clear that KFC's lien, obtained through equitable subrogation, trumps the Trustee's status as a judicial lien creditor. Shields had a properly perfected security interest in the Debtor's Ford. Under the doctrine of equitable subrogation, KFC is entitled to the same status as Shields. Therefore, KFC has a properly perfected lien on the Debtor's Ford. Under North Carolina law, KFC's rights, as the holder of a perfected security interest, are superior to the rights of the Trustee as a hypothetical judicial lien creditor. N.C. Gen. Stat. § 25-9-301 (1979).

Therefore, KFC is entitled to an allowed secured claim in the Debtor's bankruptcy case on the Debtor's Ford. KFC is not attempting to usurp the first priority rights held by Auto Finance, and will hold a second lien on the Ford.

THEREFORE, THE FOLLOWING IS ORDERED:

Based on the facts of this case, the doctrine of equitable subordination should apply. Accordingly, KFC will be allowed a secured claim in the amount of \$3,863.40. KFC will have a second lien on the Debtor's 1987 Ford Taurus.

This is the _____ day of _____, 1995.

United States Bankruptcy Judge